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TAGS: [ECON](#) [EINV](#) [ETRD](#) [EAGR](#) [RS](#)
SUBJECT: ECONOMIC LIBERAL CRITICAL OF GOVERNMENT CONTROL OF
ECONOMY AND HANDLING OF MECHHEL INCIDENT

REF: A. MOSCOW 2201
[1](#)B. MOSCOW 2308
[1](#)C. MOSCOW 2386
[1](#)D. MOSCOW 2410
[1](#)E. MOSCOW 2434

Classified By: Economic Minister-Counselor Eric T. Schultz, Reasons 1.4
(b,d).

[1](#)1. (C) SUMMARY: In a recent discussion of broad economic issues, former Economic Development Minister Yevgeniy Yasin told ECON officers he believes PM Putin's comments on Mechel were made following poor economic advice from Deputy PM Sechin; neither Putin nor Sechin had foreseen that the Mechel incident would precipitate a plunge in Russian stock markets. On other issues, Yasin is particularly worried that new state-owned corporate champions Rostekhnologia and Olimpstroy could become vehicles for diverting funds to "Putin's friends," and that the Federal Antimonopoly Service has become the government's preferred administrative lever to apply pressure to private businesses. Yasin also believes that Russia's fears that WTO accession would render certain domestic industries such as agriculture unable to compete are greatly exaggerated. In his view, the lack of competition that many industries face is one of the basic inefficiencies in the Russian economy that must be addressed. END SUMMARY.

[1](#)2. (SBU) Former Economic Development Minister Yevgeniy Yasin discussed a broad range of economic issues facing Russia in a meeting with ECON officers August 7. (N.B. Our meeting with Yasin took place prior to the outbreak of hostilities with Georgia on August 8.) Yasin served as the Economic Development Minister from 1994 to 1997. In the late 1980s and early 1990s, he was one of the chief architects of the Soviet Union's economic reform programs. A long-time academic, Yasin taught many of Russia's current liberal economic and business elites, including investment bank Troika Dialog President Ruben Vardanyan, and Sergey Aleksashenko, the former head of Merrill Lynch Russia and former First Deputy Chairman of the Central Bank. Yasin is now the Academic Director of the Higher School of Economics.

Putin's Fit of Pique Over Mechel

[1](#)3. (C) Yasin believed that PM Putin's comments on Mechel's transfer pricing practices last month (Refs A, B) were made in a moment of anger after Mechel owner Igor Zyuzin failed to appear at a metallurgical industry conference. Putin had

received bad economic advice from Deputy PM Igor Sechin about Mechel. Neither Putin nor Sechin had foreseen that the Mechel comments would cause a precipitous drop in Russian stock markets. Yasin did not believe the GOR harbored any desire to take control of Mechel, because Zyuzin was politically neutral and posed no threat, unlike Yukos' Khodorkovskiy. (NOTE: The Federal Antimonopoly Service concluded August 13 that Mechel's pricing practices for coking coal had violated Russian anti-competition law. On August 19, the Antimonopoly Service imposed a fine of 790 million rubles, equal to about \$32 million, and directed the company to reduce its contract prices by 15 percent. END NOTE)

14. (C) Yasin spoke disparagingly of Sechin, noting that Sechin had been a Portuguese language interpreter at the FSB. Though Sechin was "clever and smart" in a general way, he was "dangerous," because he "lacked a moral center" and did not always use his powers for good. Sechin was also not savvy about economic issues. In Yasin's view, there were legitimate reasons why the prices Mechel charged its overseas affiliates for coking coal differed from those it charged domestic customers, including the timing of contracts and spot prices for coal.

Heavy Hand of Government in the Economy

15. (C) Yasin said he was concerned about the recent creation of state-owned corporate champions such as Rostekhnologiya, Olimpstroy, Rosnanotekh and Rosatom. The GOR had intentionally chosen to create state corporations, instead of

joint stock companies, because they would not be subject to audits and other regulatory oversight under the Budgetary Code. While in theory an argument could be made that the new corporations would thus have a freer hand to stimulate economic development in certain sectors, in reality Yasin worried that the new corporations could serve as a mechanism for channeling money "to Putin's friends."

16. (C) In particular, Yasin thought that Olimpstroy and Rostekhnologiya would operate in a non-transparent manner. Both Former Sochi mayor and Olimpstroy head Viktor Kolodyazhniy and Rostekhnologiya head Sergey Chemezov would have "virtually unlimited resources" at their disposal, and they had reputations for being corrupt. Yasin was less worried about Rosnanotekh, given that incoming head Anatoliy Chubays was considered an honest broker largely free of corruption.

17. (C) Yasin also worried that state corporations would reduce the amount of competition in some sectors at a time when the Russian economy actually needed more internal competition. Chemezov at Rostekhnologiya, for instance, appeared intent on acquiring the assets of the companies' potential competitors and rivals. Yasin was again less concerned about Rosnanotekh, given that it would operate in an "empty market," since a nanotechnology industry had not yet developed in Russia.

18. (C) In the current inflationary environment, Yasin believed that the Federal Antimonopoly Service (FAS) had replaced the Federal Tax Service as the GOR's preferred vehicle for applying administrative pressure on private businesses. Although Putin had tasked FAS with launching more price fixing investigations in order to help moderate inflation, the agency lacked the personnel and expertise to tackle its new investigatory role. The FAS was also a "crude instrument" for attempting to tackle inflation, and would not bring any results in the near to medium term in stemming inflation.

19. (C) Commenting on economic developments since the financial crisis ten years ago, Yasin said that had it not been for the capital flight that followed the Yukos affair, the Russian economy would have averaged ten percent annual GDP growth, instead of 6-8 percent.

WTO Entry: Fear of Harm to Domestic Industries Exaggerated

¶10. (C) In Yasin's view, the fear that domestic industries such as agriculture would be harmed by Russia's WTO accession was exaggerated. Many Russian industries were already insulated from competition, either because of geography or because of a lack of competitors in Russia's still developing economy. Yasin said the Higher School of Economics had conducted a study with the World Bank that concluded that 20 percent of Russian manufacturers enjoyed a monopoly position in the Russian market, while 30 percent faced competition only from other Russian producers.

¶11. (C) Yasin cited the example of a breadmaking business in the provincial city of Tarusa, 150 kilometers southwest of Moscow. The breadmaker effectively had a monopoly position in the marketplace, since there were no other competing businesses within 50 kilometers, and no producers or distributors with a national reach had entered the region. WTO entry would help reduce Russia's economic isolation and hold out the prospect of bringing a healthy dose of competition to many industries.

¶12. (C) In the event of WTO accession, he believed initially Russia would side with developing countries such as India and China in demanding greater concessions on agricultural subsidies from the EU and United States in the Doha Round. Eventually, Russia's interests would align more with those of developed countries, as Russian policy makers realized that cooperative production ventures with the West and opening up the Indian and Chinese markets would help diversify the Russian economy.

What is Russia's Place in the BRIC?

¶13. (C) On Russia's place within the BRIC countries, Yasin said that it was inappropriate to think of Russia in the same terms as Brazil, India and China. Yasin did not share Goldman Sachs' view of the BRIC as the major developing economies, and he had stated as much when he spoke at a BRIC Conference sponsored by Goldman Sachs in Tokyo in 2006. Russia had a declining population and labor force, unlike the other three countries. Yasin viewed the real emerging economies as India, China and Southeast Asian economies like Indonesia and Vietnam. Brazil also did not fit neatly into the BRIC, and in Yasin's view, the Latin American economies, led by Brazil, Mexico and Argentina, had their own special circumstances that made them a separate economic group.

Comment

¶14. (C) Yasin's comments on the government's role in the economy are consistent with those we have heard recently from other leading economists and investment advisers (Refs C, D, E). If Russia's economy is to diversify beyond resources like oil and gas into value-added goods, more competition and less government intervention in the economy are needed. However, with the Mechel and TNK-BP incidents, and the creation of new state corporations, the GOR seems more interested in pursuing control of the economy, rather than moving toward the ideals of economic reform and global integration that President Medvedev promised when he took office in May.
BEYRLE